# Sime Diamond Leasing (M) Sdn Bhd v JB Precision Moulding Industries Sdn Bhd (In liquidation)

FEDERAL COURT (KUALA LUMPUR) — CIVIL APPEAL NO 02–5 OF 1998
CHONG SIEW FAI CJ (SABAH & SARAWAK), EDGAR JOSEPH AND MOHAMED DZAIDDIN FCJJ
7 NOVEMBER 1998

***Companies and Corporations*** — *Winding up — Undue preference — Whether set-off pursuant to lease agreement was undue preference — Disposition within meaning of s 223 of Companies Act 1965 — Whether relevant date is date of set-off and not date of transaction — Companies Act 1965 ss 223 & 293 — Bankruptcy Act 1967 s 53(1)*

***Companies and Corporations*** — *Winding up — Right to set off — Whether right of set-off would give lessor undue preference over other creditors contrary to s 293 of Companies Act 1965 and s 53(1) of the Bankruptcy Act 1967 — Whether provisions of agreement which give right of set-off should be struck down*

The Appellant ('the Lessor') had entered into an Equipment Lease Agreement dated 30 December 1988 ('the Agreement') whereby it had leased to the Respondent ('the Lessee'), one unit 'Elite E 330 B Plastic Injection Moulding Machine'. Pursuant to the Agreement, the Lessee had deposited with the Lessor a prepaid rent of RM3,958 and a sum of RM64,500 as security for the due performance of the Agreement ('the deposits'). Payment of the deposits was evidenced by a Memorandum dated 30 December 1988. Clause 14.1(g)(ii) of the Agreement provided, inter alia, that in the event of a Winding-Up Petition being presented against the Lessee, the Lessor shall be entitled by written notice to determine and end the Lease and to retake possession of the equipment. On 27 March 1990, the Lessor gave Notice of Termination of the Agreement on the ground that the presentation of Winding-up Petition constituted a breach of the Agreement and, at the same time, demanding payment of the amount outstanding after setting-off the deposits pursuant to cl 4.3 of the Agreement. On 4 April 1990, the Lessee was wound up and a Liquidator appointed. The Liquidator demanded from the Lessor the return of the deposits but the Lessor refused to comply. Counsel for the Lessee put his case thus: upon presentation of the petition, the claim in respect of the deposits had been reduced to a right of proof and that any other method of claiming the deposits would be barred by the pari passu principle of distribution; furthermore, to give the Lessor the right of set-off would, in effect, give it an undue preference, over the general body of creditors, contrary to s 293 of the Companies Act 1965, read together with s 53(1) of the Bankruptcy Act 1967, and so the provisions of the Agreement which purport to give the right of set-off should be struck down as being in violation of those provisions, and, therefore, void. Both in the High Court and the Court of Appeal, the Liquidator succeeded. The Lessor then appealed to this Court. The two key issues which arise for decision in this appeal are: (i) whether the set-off pursuant to cl 4.3 of the Agreement was a voidable preference under ss 223 and 293 of the

Companies Act, read together with s 53(1) of the Bankruptcy Act?; and (ii) If 'no', then whether, the set-off pursuant to the Agreement was authorized by s 41 of the Bankruptcy Act, which is made applicable to insolvent companies by s 291 of the Companies Act? A

**Held**, allowing the appeal with costs: B

(1) In considering the question whether there has been a disposition within the terms of s 223 of the Companies Act, the relevant date is *not* the date of the set-off but the date of the transaction. In this case, the transaction had been concluded long before the onset of the twilight period — statutorily defined as six months prior to the commencement of the winding up. C

It was, therefore, a serious misdirection to have treated the relevant time for purposes of s 223 of the Companies Act as the date of the set-off. In consequence of this misdirection, both the High Court and the majority in the Court of Appeal failed to take into account the fact that as at the time of the transaction D concerned — ie on 30 December 1988, when the deposits had passed into the hands of the Lessor — no evidence had been adduced that the Lessee was insolvent or unable to pay its debts or that the intention of the parties was to confer a preferential priority or advantage over other creditors. Indeed, the transaction bore all the badges of a normal straightforward transaction carried E out in the normal course of the Lessor's business, and wholly consistent with the industry. Therefore, the Court is not empowered to make an order setting aside the payments of the deposits (see pp 579I and 580A–C).

(2) The Lessor was entitled to the statutory set-off provided for by F s 41 of the Bankruptcy Act, in respect of the deposits, regard being had to the fact that there had been 'mutual dealings' within the meaning of the section, between it and the Lessee and the operation of the statutory set-off was reinforced by cl 4.3 of the Agreement which authorized the Lessor to set-off the deposits G against the amounts owing thereunder upon termination of the lease on winding up. The majority of the Court of Appeal had thus erred in Law in holding that there had been no mutual credits, mutual debts or other mutual dealings between the Lessor and the Lessee (see p 583E–F).

H

**Obiter**:

There was no requirement to register the Memorandum of Deposit pursuant to s 108 of the Companies Act because the date of the transaction was prior to the coming into force of the new s 108(3)(k) I of the Companies Act which requires a charge on the credit balance of the company in any deposit account to be registered with the Registrar of Companies within 30 days after its creation. Even if there had been a breach of s 108(1) of the Companies Act, the effect

would have been merely to render void the security on the company's property or undertaking but the contract or obligation for repayment of the money secured by the charge, would be valid and enforceable, and immediately become payable (see pp 583H–I and 584A).

**[Bahasa Malaysia summary**

Perayu ('Pemberi Pajak') telah mengikat suatu Perjanjian Pajakan Peralatan bertarikh 30 Disember 1988 ('Perjanjian tersebut') di mana dia telah memajakkan kepada Penentang ('Penerima Pajak') satu unit 'Mesin Pengacuan Suntikan Plastik Elite E 330 B'. Menurut Perjanjian tersebut, Penerima Pajak telah membayar kepada Pemberi Pajak sewaan awal sebanyak RM3,958 dan jumlah sebanyak RM64,500 sebagai cagaran untuk pelaksanaan Perjanjian tersebut ('deposit tersebut'). Pembayaran deposit tersebut telah dibuktikan oleh suatu Memorandum bertarikh 30 Disember 1988. Fasal 14.1(g)(ii) Perjanjian tersebut memperuntukkan, antara lain, bahawa sekiranya Petisyen Penggulungan dibuat terhadap Penerima Pajak, Pemberi Pajak hendaklah berhak melalui notis bertulis untuk menamatkan Pajakan tersebut dan memiliki kembali peralatan tersebut. Pada 27 Mac 1990, Pemberi Pajak memberikan Notis Penamatan Perjanjian tersebut atas alasan pengemukaan Petisyen Penggulungan merupakan satu kemungkiran Perjanjian tersebut dan, pada masa yang sama, menuntut pembayaran jumlah yang belum dibayar selepas tolakan deposit tersebut menurut fasal 4.3 Perjanjian tersebut. Pada 4 April 1990, Penerima Pajak telah digulung dan Penyelesai telah dilantik. Penyelesai menuntut daripada Pemberi Pajak untuk mengembalikan deposit terebut tetapi Pemberi Pajak enggan berbuat demikian. Hujah peguam Penerima Pajak adalah: apabila petisyen dikemukakan, tuntutan terhadap deposit tersebut telah bertukar menjadi hak pembuktian dan sebarang kaedah lain untuk menuntut deposit tersebut akan terhalang oleh prinsip pengagihan pari passu; tambahan pula, memberikan Penerima Pajak hak untuk membuat tolakan akan, dari segi kesannya, memberikan keutamaan tak wajar berbanding dengan pemiutang lain, bercanggah dengan s 293 Akta Syarikat 1965, dibaca bersama dengan s 53(1) Akta Kebankrapan 1967, dan dengan itu peruntukan Perjanjian tersebut yang kononnya memberi hak untuk tolakan sepatutnya dibatalkan kerana ia merupakan pelanggaran peruntukan tersebut, dan oleh itu, tidak sah. Hujah Penyelesai diterima di kedua-dua Mahkamah Tinggi dan Mahkamah Rayuan. Pemberi Pajak kemudiannya merayu kepada Mahkamah ini. Dua isu utama yang berbangkit untuk diputuskan dalam rayuan ini adalah: (i) sama ada tolakan menurut fasal 4.3 Perjanjian tersebut adalah keutamaan yang boleh batal di bawah ss 223 dan 293 Akta Syarikat, dibaca bersama dengan s 53(1) Akta Kebankrapan?; dan (ii) Jika 'tidak', sama ada tolakan menurut Perjanjian tersebut dibenarkan oleh s 41 Akta Kebankrapan, yang dibenarkan diterimapakai untuk syarikat-syarikat tak solven di bawah s 291 Akta Syarikat?

**Diputuskan**, membenarkan rayuan dengan kos:

(1) Dalam mempertimbangkan persoalan sama ada telah terdapat satu pelupusan mengikut terma s 223 Akta Syarikat, tarikh yang relevan *bukanlah* tarikh tolakan tetapi tarikh transaksi. Dalam kes ini, transaksi telah lama disempurnakan — yang ditakrifkan secara statutori sebagai enam bulan sebelum bermulanya penggulungan.

Oleh itu, adalah satu salah arah yang serius untuk menganggap masa yang relevan untuk tujuan s 223 Akta Syarikat sebagai tarikh tolakan. Lanjutan dari salah arah ini, kedua-dua Mahkamah Tinggi dan Mahkamah Rayuan secara majoriti telah gagal untuk mengambil kira fakta bahawa pada masa transaksi berkenaan — iaitu pada 30 Disember 1988, bila deposit tersebut telah diterima oleh Pemberi Pajak — tiada bukti telah dikemukakan bahawa Penerima Pajak adalah tidak solven atau tidak berupaya membayar hutang-hutangnya atau bahawa pihak-pihak berhasrat memberikan prioriti keutamaan atau kelebihan ke atas pemiutang lain. Malahan, transaksi tersebut mempunyai semua ciri-ciri satu transaksi yang biasa dan jujur yang dibuat dalam urusan perniagaan Pemberi Pajak, dan adalah konsisten sepenuhnya dengan industri berkenaan. Maka, Mahkamah tidak mempunyai kuasa untuk membuat perintah untuk mengetepikan pembayaran deposit tersebut (lihat ms 579I dan 580A–C).

(2) Pemberi Pajak mempunyai hak untuk tolakan statutori sebagaimana diperuntukkan di bawah s 41 Akta Kebankrapan, berhubung dengan deposit tersebut, mengambil kira fakta bahawa telah wujud 'mutual dealings' dalam lingkungan maksud seksyen tersebut, di antaranya dan Penerima Pajak dan operasi tolakan statutori diperkukuhkan oleh fasal 4.3 Perjanjian tersebut yang memberi kuasa kepada Pemberi Pajak membuat tolakan deposit terhadap amaun yang terhutang di bawahnya bila mana pajakan ditamatkan apabila digulung. Justeru itu Mahkamah Rayuan secara majoriti telah silap dari segi Undang-Undang dalam memutuskan telah tidak terdapat kredit secara persetujuan, hutang secara persetujuan atau urusan lain secara persetujuan di antara Pemberi Pajak dan Penerima Pajak (lihat ms 583E–F).

**Obiter**:

Tidak ada keperluan untuk mendaftar Memorandum Deposit menurut s 108 Akta Syarikat kerana tarikh transaksi adalah sebelum berkuatkuasanya s 108(3)(k) Akta Syarikat yang baru yang memerlukan cagaran baki kredit sesebuah syarikat dalam mana-mana akaun deposit didaftarkan dengan Pendaftar Syarikat dalam masa 30 hari selepas ia wujud. Walaupun terdapat kemungkiran s 108(1) Akta Syarikat, kesannya hanyalah menjadikan cagaran ke atas harta syarikat atau akujanji tidak sah tetapi kontrak atau obligasi untuk pembayaran pinjaman yang bercagar dengan gadaian adalah

sah dan boleh dikuatkuasakan, dan dengan serta merta boleh dituntut, (lihat ms 583H–I dan 584A).]

**Notes**

For cases on winding up generally, see 3 *Mallal's Digest* (4th Ed, 1997 Reissue) paras 618–918.

**Cases referred to**

*A Debtor, Re* [1927] 1 Ch 97 (refd)
*BP Fowler Ltd, Re* [1937] 3 All ER 781 (refd)
*Barter, Ex parte; Re Walker* (1884) 26 Ch D 510 (refd)
*British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758 (refd)
*Calzaturificio Zenith Pty Ltd v NSW Leather and Trading Co Pty Ltd* [1970] VR 605 (refd)
*Doe d Hunter v Dalliers* (1778) 2 Term Rep 133 (refd)
*Eberle's Hotels and Restaurant Co Ltd v E Jonas & Brothers* (1887) 18 QBD 459 (refd)
*Forster v Wilson* (1843) 12 M & W 191 (refd)
*Gye v McIntyre* (1991) 171 CLR 609 (refd)
*Higginbotham v Holme* [1812] 19 Ves Jun 88, 92-3 (refd)
*Hiley v Peoples Prudential Assurance Co Ltd (In liquidation)* (1938) 60 CLR 468 (refd)
*Ince Hall Rolling Mills Co Ltd, The v The Douglas Forge Co* (1882) 8 QBD 179 (refd)
*JB Precision Moulding Industries Sdn Bhd (In liquidation) v Asia Commercial Finance (M) Sdn Bhd* [1994] 1 MLJ 734 (refd)
*Jack v Kipping* (1882) 9 QBD 113 (refd)
*Jackson, Ex parte* (1880) 14 Ch D 725 (refd)
*Jay, Ex parte; Re Harrison* [1880] 14 Ch D 19 (refd)
*Johnson, Re* [1904] 1 KB 134 (refd)
*Kim San Engineers Pte Ltd, Re* [1992] 2 SLR 749 (refd)
*Lian Keow Sdn Bhd & Anor v Overseas Credit Finance (M) Sdn Bhd & Ors* [1988] 2 MLJ 449 (refd)
*Lloyds Banks NZA Ltd v National Safety Council of Australian Victorian Division (In Liquidation)* [1993] 2 VR 506 (refd)
*Mackay, Ex parte* (1873) 8 Ch App 643 (refd)
*Mackinstosh v Pogose* [1895] 1 Ch 505 (refd)
*National Westminister Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785 (refd)
*Peat v Jones & Co* (1881) 8 QBD 147 (refd)
*Peel v Fitzgerald* (1882) Qd R 544 (refd)
*Piggin, Re; Dicker v Loambank* (1962) 112 LJ 424 (refd)
*Rolls Razor Ltd v Cox* [1967] 1 QB 552 (refd)
*Rouch v Great Weston Railway Co* [1841] 1 QB 51 (refd)
*Shand v MJ Atkinson Ltd* [1966] NZLR 551 (refd)
*Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 (refd)

*Stein v Blake* [1995] 2 All ER 961 (refd)
*Stevens v Copp* (1868) LR 4 Exch 20 (refd)
*Studley v Boylston National Bank of Boston* (1913) 229 US 523 (refd)
*Tilley v Bowman Ltd* [1910] 1 KB 745 (refd)
*Washington Diamond Mining Co, Re* [1893] 3 Ch 95 (refd)
*Whitmore v Mason* (1861) 2 John & H 204, 70 ER 1031 (refd)
*Wilson v Greenwood* (1818) 1 Swans 471; 59 ER 551 (refd)

**Legislation referred to**

Bankruptcy Act 1967 ss 2, 40, 41, 53, (1)
Companies Act 1965 ss 108, (3)(k), 222, 223, 224, 233, 264, 291(2), 292, 293, (1)

**Appeal from**: Civil Appeal No J–02–504 of 1995 (Court of Appeal, Kuala Lumpur)

*Chang Mun Fong* (*Low Chi Cheng* with her) (*Lim Kian Leong & Co*) for the appellant.

*Ong Ban Chai* (*Soon Eng Thye* with him) (*Ong Ban Chai & Co*) for the respondent.

**Edgar Joseph Jr FCJ** (delivering judgment of the court):

*The Background Facts*

In this appeal the essential facts to be garnered from the affidavits filed fall to be stated within a short compass.

The Appellant ('the Lessor') had entered into an Equipment Lease Agreement dated 30 December 1988 ('the Agreement') whereby it had leased to the Respondent ('the Lessee'), one unit 'Elite E 330 B Plastic Injection Moulding Machine' with accompanying parts upon the terms and conditions appearing therein. Pursuant to those terms, the Lessee had deposited with the Lessor a prepaid rent of RM3,958 ('the Prepaid Rent') and a sum of RM64,500 ('the Security Deposit') as security for the due performance of the Agreement. Payment of the Security Deposit and the Prepaid Rent was evidenced by a Memorandum dated 30 December 1988 ('the Memorandum of Deposit').

For brevity and convenience we shall, unless the context otherwise requires, refer to the Pre-Paid Rent and the Security Deposit as 'the deposits'.

Clause 14.1(g)(ii) of the Agreement provided, inter alia, that in the event of a Winding-Up Petition being presented against the Lessee, the Lessor shall be entitled by written notice to determine and end the Lease and to retake possession of the equipment.

In the events which happened, on 27 March 1990, the Lessor gave Notice of Termination of the said Agreement on the ground that the presentation of Winding-up Petition constituted a breach of the Agreement and, at the same time, demanding payment of the amount outstanding

after setting-off the deposits pursuant to cl 4.3 of the Agreement which provided, inter alia, that if the Lessee is in default under any of the provisions of the Agreement, including events referred to in cl 14, then the Lessee shall be entitled to apply the deposits or any part thereof against the amount outstanding under the Agreement.

Then, on 4 April 1990, the Lessee was wound up and a Liquidator appointed. On 23 April 1990, the Liquidator demanded from the Lessor the return of the deposits but the Lessor refused to comply.

*The Proceedings*

In the upshot, the Liquidator applied by way of Originating Motion for the refund of the deposits, which had been set-off by the Lessor. The Liquidator relied on the following grounds:

(1) the deposits paid by the Lessee belonged to the estate of the Lessee, this was so, because the Lessor being neither a secured creditor nor a preferential creditor within the meaning of s 2 of the Bankruptcy Act 1967, and s 292 of the Companies Act 1965, respectively, was not entitled to keep the same;

(2) the deposits represented the assets of the Lessee and thus the Liquidator must take under s 233 of the Companies Act; and

(3) the forfeiture by the Lessor of the deposits was void against the Liquidator and amounted to a fraudulent undue preference under s 223 and s 293 of the Companies Act, read with s 53 of the Bankruptcy Act. The case of *Lian Keow Sdn Bhd & Anor v Overseas Credit Finance (M) Sdn Bhd & Ors* [1988] 2 MLJ 449 was cited in support.

We hope it is not an unfair summary of the submissions of Counsel for the Lessee if we put his case thus: upon presentation of the petition — that being the material date — see, *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 — the claim in respect of the deposits had been reduced to a right of proof and that any other method of claiming the deposits would be barred by the pari passu principle of distribution which is fundamental and all pervasive being enshrined in s 264 and supported by ss 222, 223 and 224 of the Companies Act. Furthermore, — so the submission ran — to give the Lessor the right of set-off, in the particular circumstances of this case would, in effect, give it an undue preference, over the general body of creditors, contrary to s 293 of the Companies Act, read together with s 53(1) of the Bankruptcy Act, and so the provisions of the Agreement which purport to give the right of set-off should be struck down as being in violation of those provisions, and, therefore, void.

Both in the High Court and the Court of Appeal (Abdul Malek Ahmad JCA, dissenting), the Liquidator succeeded (see [1997] 1 MLJ 499). The Lessor then appealed to this Court pursuant to leave to appeal having been granted.

*Preliminary*

It is well known that parties when dealing with each other may by contract confer upon themselves a right of set-off, the intention and effect of which is that the party who is later the defendant may contend that under the relevant agreement he is entitled to exercise self-help by setting one obligation against the other thus extinguishing the other obligation pro tanto. When both parties are solvent, no difficulties arise. But, with the advent of bankruptcy or a winding up of either party, contractual and equitable rights of set-off are replaced by the statutory set-off provisions the effect of which is that contractual provisions which travel beyond the perimeters of what is permitted by the statutory provisions will not survive liquidation or bankruptcy, as being in violation of the fundamental principle of pari passu distribution. (See, eg *British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758).

*The Issues*

It is against the background of the general remarks aforesaid that we turn to consider the two key issues which arise for decision in this appeal; namely:

(1) whether the set-off pursuant to cl 4.3 of the Agreement was a voidable preference under ss 223 and 293 of the Companies Act, read together with s 53(1) of the Bankruptcy Act?

(2) If 'no', then whether, the set-off pursuant to the Agreement was authorized by s 41 of the Bankruptcy Act, which is made applicable to insolvent companies by s 291 of the Companies Act?

*As to Issue (1)*

A preliminary question which arises for decision on this part of the case is whether cl 4.3 in the Agreement which provides for the determination of the lease upon presentation of a winding-up petition was a contravention of the pari passu principle which is fundamental and all pervasive. No less an authority than Professor Goode has considered this very question in his book *Principles of Corporate Solvency* (1990) at p 66 and has expressed the view that it does *not* since it is merely a qualification of the lessee's estate. (See, *Doe d Hunter v Dalliers* (1778) 2 Term Rep 133).

Professor Goode's opinion is supported by the following passage in the judgment of Lord Heatherley in *Whitmore v Mason* (1861) 2 John & H 204 at p 210:

> ... The general distinction seems to be that the owner of property may on alienation, qualify the interest of his alienee by a condition to take effect on bankruptcy; but cannot by contact or otherwise, qualify his own interest by a like condition, determining or controlling it in the event of his own bankruptcy or delay of his creditors.

A It should be noted that Lord Heatherley was merely repeating a statement of principle first enunciated by Mr Clement Swanston in a note to his report of the judgment of Lord Eldon in *Wilson v Greenwood* (1818) 1 Swans 471; 59 ER 551.

Indeed, there is a consistent current of judicial opinion accepting the B statement of principle enunciated by Mr Clement Swanston. So, for example, in *Mackinstosh v Pogose* [1895] 1 Ch 505, in a marriage settlement, if husband and wife bring property into the settlement, a trust of the income of the wife's property for the benefit of the husband until his bankruptcy, is valid. However, a similar trust of the income of the husband's property, such that the husband's interest ceases upon his bankruptcy, is C invalid. Again, in a building contract situation, where the contract provided that in the event of the builder becoming bankrupt or insolvent, any of his materials and chattels lying on the premises were to be forfeited to the owner, it was held that the provision for forfeiture was an attempt to qualify the interest of the builder in his property upon the occurrence of D his bankruptcy, and so was struck down as being void with the result that the building materials became the property of the trustee in bankruptcy. (See *Ex parte Jay; Re Harrison* [1880] 14 Ch D 19. See also, *Rouch v Great Weston Railway Co* [1841] 1 QB 51 at pp 64–65; *Ex parte Barter, Re Walker* (1884) 26 Ch D 510 (ship building contract)).

Similarly, a provision in a deed of partnership that in the event of the E bankruptcy or insolvency of a partner, his share in the partnership property was to vest in his co-partners was held in *Whitmore v Mason* (1861) 70 ER 1031 to be void for the same reason and with the same consequences.

On the other hand, there is the judgment of the Norwich County Court in *Re Piggin, Dicker v Loambank* (His Honour Judge Carey Evans) F (15 May 1962) 112 LJ 424. The issue which arose for decision in that case was what interest, if any, a trustee in bankruptcy, had in an Austin motor van which was in the possession of a bankrupt trader at the time of bankruptcy as hirer under a hire purchase agreement, which, by cl 5(iv) provided, inter alia, that the hiring and the agreement should end if the G hirer should commit any act of bankruptcy or have a receiving order made against him, giving the owner the right to immediate possession. It was held that the provision cl 5(iv) was void and, therefore, not exercisable to the prejudice of the trustee in bankruptcy, at least, if he tenders the balance of the hire purchase charges. In so holding, the learned Judge applied the principle in bankruptcy law enunciated by James LJ in *Ex parte* H *Mackay* (1873) 8 Ch App 643: by analogy,:

> a man is not allowed, by stipulation with a creditor to provide for a different distribution of his effects in the event of bankruptcy from that which the law provides.

We would interpolate, to observe, that in *Ex parte Jackson* (1880) 14 Ch D I 725 at p 741, Cotton LJ described as a fraud on the bankruptcy law a clause that he said was an attempt to alter or disturb the legal distribution of the mortgagor's property in bankruptcy.

Reverting to *Re Piggin*, Professor Goode in his book, *Principles of Corporate Insolvency* (1990) at p 66 says this:

> It is thought that this (*Re Piggin*, etc) will not be followed. Though the doctrine of estates does not apply to chattels, the provision for termination of the agreement on bankruptcy qualifies the possessory interest in much the same way as on a lease of property. Provisions for termination on winding-up are commonly found in a wide range of contracts including technology licensing agreements where this effect can be devasting, destroying the company's business.

And, immediately before, on the same page of his book, Professor Goode, says this:

> A provision for forfeiture of a lease on winding-up appears not to contravene the pari passu principle since it is merely a qualification of the lessee's estate. (See, *Doe d Hunter v Galliers* (1787) 2 Term Rep 133).

And, directing attention to the distinction drawn by Lord Heatherley in *Whitmore v Mason*, quoted above, Professor Goode, points out, by way of illustration, that the distinction forms the basis of the protective trust, a well established device for ensuring that an individual can have property conferred upon him without risking its forfeiture to creditors on bankruptcy, the determinable interest giving way on bankruptcy to a discretionary trust.

We prefer Professor Goode's views to those of Judge Carey Evans in *Re Piggin* although we recognise the intellectual force of the reasoning of the latter. In our view, there is nothing objectionable in 'qualifying' a contractual right by a provision for termination of the contract upon liquidation. (See in *Re Johnson* [1904] 1 KB 134 at pp 136–137). This does not operate to deprive the company's creditors of the benefit of an asset that would otherwise have been available to them, but merely operates to define the scope of the rights flowing from the contract. So, for example, a lease may provide for its determination in the event of bankruptcy. This is valid subject to relief against forfeiture because it is a reservation by the owner of property of a power over it. (See, Lord Eldon in *Higginbotham v Holme* [1812] 19 Ves Jun 88, 92-3; *Stevens v Copp* (1868) LR 4 Exch 20 at pp 23–24).

We must now turn to consider s 293 of the Companies Act. The Law relating to fraudulent preferences is set out in s 53 of the Bankruptcy Act, which is made applicable to conpanies by s 293 of the Companies Act, and is designed to preserve the sanctity of the pari passu principle by which creditors in a winding up share rateably in the assets available for distribution. As in bankruptcy cases, a creditor of a company is not entitled to a set-off against his obligation to repay the preference. (See, *Re A Debtor* [1927] 1 Ch 97; *Calzaturificio Zenith Pty Ltd v NSW Leather and Trading Co Pty Ltd* [1970] VR 605).

We note, in passing, that in *Lian Keow Sdn Bhd & Anor v Overseas Credit Finance (M) Sdn Bhd & Ors* [1988] 2 MLJ 449 Seah SCJ, speaking in the Supreme Court, held that the rules of bankruptcy as to fraudulent preferences are applied to the winding up of companies.

A To take the matter further, it is clear law that the Court has no power to make an order setting aside payments and transfers made in the run-up to bankruptcy in favour of a particular creditor which were designed to prefer him over other creditors unless the following five conditions are satisfied:

B (1) that the transaction in question took place within six months prior to the commencement of winding up;

(2) that it satisfies the description of one of the types of transaction mentioned in s 53(1) of Bankruptcy Act;

(3) that it took place at a time when the company was insolvent;

C (4) that the person in whose favour the transaction was effected stood in the relation of creditor to the Company; and

(5) the effect of the transaction was to confer on that person a preference, priority or advantage over other creditors in the winding up.

D The onus was, of course upon the Liquidator to satisfy *all* the five requirements aforesaid.

In the High Court, at Johore Bahru, the learned Judge had held that the relevant date for determining whether the Liquidator had satisfied the requirements was the date of the set-off and that at that point of time all the five requirements were satisfied. In the Court of Appeal — Abu E Mansor JCA — one of the two Judges who comprised the majority — shared that view.

The principle of central importance underlying s 293(1) of the Act is that where a debtor company, has at a *relevant time*, given a preference to any person, the liquidator may apply to the Court for an order under the F section setting aside the preference.

The object of the rules of bankruptcy as to fraudulent preferences is to prevent a creditor from obtaining for himself an unfair advantage at the expense of other creditors by concluding a *transaction* with the company during what has been called the twilight period which precedes winding G up. Bearing this in mind, it is difficult to see how, in the present case, it could be said that the relevant date for determining whether the Liquidator had satisfied the requirements was the date of the set-off. After all, the claim for a set-off in respect of the deposits arose out of a transaction which took the form of the Agreement pursuant to which the deposits were paid as evidenced by the Memorandum of Deposit, execution of both H these documents and the payment having been effected contemporaneously, on 30 December 1988, that is to say, as far back as 11 months before the presentation of the Winding Up Petition.

In other words, in considering the question whether there has been a disposition within the terms of s 223 of the Companies Act, the relevant I date is *not* the date of the set-off but the date of the transaction. Thus, we are here concerned with a transaction which had been concluded long before the onset of the twilight period — statutorily defined as six months prior to the commencement of the winding up.

It was, therefore, a serious misdirection to have treated the relevant time for purposes of s 223 of the Companies Act as the date of the set-off. In consequence of this misdirection, both the High Court and the majority in the Court of Appeal took a wrong turning and, as a result, failed to take into account the fact that as at the time of the transaction concerned, that is to say, on 30 December 1988, when the deposits had passed into the hands of the Lessor, no evidence had been adduced to show that the Lessee was insolvent or unable to pay its debts or that the intention of the parties was to confer a preferential priority or advantage over other creditors. Indeed, it could not be gainsaid that the transaction bore all the badges of a normal straightforward transaction carried out in the normal course of the Lessor's business, and wholly consistent with the industry.

It follows, that none of the five conditions aforesaid empowering the Court to make an order setting aside the payments of the deposits had been satisfied.

We must therefore answer the first key issue in favour of the Lessor.

*As to Issue (2)*

We now turn to consider the second key issue which arose for decision.

By way of introduction to this part of the case, we think we should say a few words about the nature of insolvency set-off which, as Parke B put it in *Forster v Wilson* (1843) 12 M & W 191 (at pp 203–204), is designed 'to do substantial justice between the parties'. This statement is unobjectionable if 'the parties' is taken to include the bankrupt's general body of creditors. (See, *Lloyds Banks NZA Ltd v National Safety Council of Australian Victorian Division (In liquidation)* [1993] 2 VR 506 at p 513.)

Clearly, the legislature in providing for insolvency set-off gives legitimacy to a system of accounting whereby the party successfully asserting the set-off enjoys a preference over the general body of creditors in a manner similar to that enjoyed by a secured creditor.

To put it another way, the possibility of a set-off may be seen as a form of security (see, *Re Washington Diamond Mining Co* [1893] 3 Ch 95 at p 104 where Vaughan Williams J referred to 'the security by way of set-off'; also *Stein v Blake* [1995] 2 All ER 961 at p 964), though it is not a security in the strict sense of the word, yet its existence, in many cases, would inspire a degree of confidence in parties dealing with each other. Indeed, in *Studley v Boylston National Bank of Boston* (1913) 229 US 523 at p 529 Lamar J speaking for the Supreme Court, cautioned that the abolition of the right of set-off could 'interfere with the course of business as to produce evils of serious and far reaching consequence'.

Professor Goode in his book *Legal Problems of Credit and Security* (2nd Ed) (at p 177) has explained that the justification for the preference accorded to the party successfully asserting the set-off, is based on the notion of an express or implied agreement, without which credit would not have been extended to the bankrupt in the first place, and by which, the creditor was to be entitled to take what was due to him out of the security

in the one case and out of his own indebtedness in the other. Thus, the right of set-off enhances the provision of credit facilities and generally acts as a stimulus to trade and commerce.

Turning from the general to the particular, it is clear law that upon the advent of bankruptcy or liquidation, the rights of contractual set-off are displaced by statutory provisions relating to set-off on insolvency. The applicable legislation relating to set-off on company winding-up is to be found in the statutory provisions governing set-off on bankruptcy. To put it another way, the statutory provisions governing bankruptcy set-off are incorporated by reference into the provisions relating to company winding-up; specifically, ss 40 and 41 of the Bankruptcy Act, are incorporated by reference to companies by virtue of s 291(2) of the Companies Act. Section 41 of the Bankruptcy Act is, of course, the section which obliges a creditor who engages in mutual dealings with the company and is also its debtor, to set-off the debts and prove only for the balance. More particularly, s 41 says this:

> (1) Where there have been mutual credits, mutual debts, or other mutual dealings between a debtor against whom a receiving order is made under this Act and any other person proving or claiming to prove a debt under such order, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set-off against any sum due from the other party, and the balance of the account and no more shall be claimed or paid on either side respectively.
>
> (2) A person shall not be entitled under this section to claim the benefit of any set-off against the property of a debtor in any case where he had at the time of giving credit to the debtor notice of an act of bankruptcy committed by the debtor and available against him.

It is important to note that the case of *Re Kim San Engineers Pte Ltd* [1992] 2 SLR 749 shows — and we agree — that where s 41 applies, payments which would otherwise be set aside under s 293 of the Companies Act may yet be retained by the creditor. We hasten to add we do not overlook the case of *JB Precision Moulding Industries Sdn Bhd (In liquidation) v Asia Commercial Finance (M) Sdn Bhd* [1994] 1 MLJ 734 where the High Court refused to allow a set-off, but with respect this case should be regarded as having been decided *per incuriam* as no reference was made therein to s 41 of the Bankruptcy Act.

Similarly, it is important to note that the case of *Re Washington Diamond Mining Co* [1893] 3 Ch 95 recognises that where s 41 of the Bankruptcy Act applies, the payment or agreement for set-off cannot be construed as a void preference under s 53 of the Bankruptcy Act. It has been said that in such a situation the fact that the debts would have been set-off in the bankruptcy means that the arrangements have not worked to the detriment of the other creditors of the company. As was well put by Vaughan Williams J in *Re Washington Diamond Mining Co* at p 104, 'You cannot prefer a man... by merely putting him in the very position in which he would be if a bankruptcy followed'.

This case should be compared with *Re BP Fowler Ltd* [1937] 3 All ER 781 where Crossman J held that the payment was a preference notwithstanding that he left open the question whether there would have been a set-off in liquidation, and on his ground his Judgment may be regarded as unsatisfactory.

For the statutory set-off provisions to apply, the circumstances of a case must disclose mutual credits, mutual debits or other mutual dealings. The prerequisite of mutual dealings requires that the cross-demands must be between the same parties, and be held in the same capacity or right (See, *The Ince Hall Rolling Mills Co Ltd v The Douglas Forge Co* (1882) 8 QBD 179 at p 183); *Shand v MJ Atkinson Ltd* [1966] NZLR 551 at p 570; *Peel v Fitzgerald* (1882) Qd R 544 at p 547).

Clearly, the provisions of s 41 of the Bankruptcy Act are mandatory and cannot be excluded by ageement between the parties. The House of Lords so held in *National Westminister Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785, HL at pp 191, 193.

And, we would add, that it is settled law that where the circumstances of the creation of mutual liabilities are such as to show that they are related — where, for example, as in the present case, they arise out of a single contact between the parties — it is impossible for the parties to exclude even by private agreement the statutory right of set-off conferred by s 41 of the Bankruptcy Act. (See, *Rolls Razor Ltd v Cox* [1967] 1 QB 552, per Denning MR at pp 569–570).

As to what the expression 'mutual dealings' encompasses, reference may be made to three cases.

In *Eberle's Hotels and Restaurant Co Ltd v E Jonas & Brothers* (1887) 18 QBD 459, Lord Esher MR said:

> There are, no doubt, matters which give rise to claims, but are not dealings within the section. If one man assaults another or injures him through negligence, that gives rise to a claim, but is not a dealing; but I am disposed to think that whatever comes within the description of an ordinary business transaction would be a dealing within the section.

Next, in *Gye v McIntyre* (1991) 171 CLR 609 at p 625, the High Court of Australia held that 'dealings' is used in a non-technical sense and is a term of very wide scope. Here is what the Court said:

> It has been construed as referring to matter having a commercial or business flavour... Even if it is correct to construe 'dealings' in [the set-off section] as confined to a commercial or business setting, it covers the communings, the negotiations, verbal and by correspondence and other matters which occur or exist in that setting. Whatever may be the outer limits of the word 'dealings' in [the set-off section], it encompasses, as a matter of ordinary language, commercial transactions, and the negotiations leading up to them.

In the words of Sir Owen Dixon in *Hiley v Peoples Prudential Assurance Co Ltd (In liquidation)* (1938) 60 CLR 468 at p 497:

> It is enough that at the commencement of the winding up mutual dealings exist which involve rights and obligations whether absolute or contingent of

> such a nature that afterwards, in the event that happen, they mature or develop into pecuniary demands capable of set-off. If the end contemplated by the transaction is a claim sounding in money so that, in the phrase employed in the cases, it is commensurable with the cross-demand, no more is required than that at the commencement of the winding up liabilities shall have been contracted by the company and the other party respectively from which cross money claims accrue during the course of the winding up.

In our view, therefore, reciprocal obligations under a contract would, usually, be mutual. To illustrate, note the following dictum of Jessel MR in *Peat v Jones & Co* (1881) 8 QBD 147 at p 149, 'a contract of sale and purchase is in its nature mutual imposing reciprocal obligations on the vendor and purchaser. Any claim arising out of mutual dealing could be set off'. To the same effect is the case of *Jack v Kipping* (1882) 9 QBD 113 where the vendor of goods had been adjudged a bankrupt, and it was held that the purchaser could set-off against the trustee's claim for the price a cross-claim for damages for fraud by the vendor, in having induced the purchaser to enter into the contract of sale and purchase. Conversely, we note the case of *Tilley v Bowman Ltd* [1910] 1 KB 745, where in a sale induced by the purchaser's fraud, it was held that the vendor, on rescinding the contract could set-off his claim to damages for the fraud against the trustee's claim for repayment of the price.

In the present case, therefore, the Lessor was entitled to the statutory set-off provided for by s 41 of the Bankruptcy Act, in respect of the deposits, regard being had to the fact that there had been 'mutual dealings' within the meaning of the section, between it and the Lessee and the operation of the statutory set-off was reinforced by cl 4.3 of the Agreement which authorized the Lessor to set-off the deposits against the amounts owing thereunder upon termination of the lease on winding up.

The majority of the Court of Appeal had thus erred in Law in holding, as they did in fact hold, that there had been no mutual credits, mutual debts or other mutual dealings between the Lessor and the Lessee.

On this further ground also, the Lessor is entitled to succeed in its appeal.

For the sake of completeness, we would add that the point was also taken by Counsel for the Lessee Company — though later abandoned — that the Memorandum of Deposit was not registered pursuant to s 108 of the Companies Act, and that in consequence the entire transaction was void as against the Liquidator.

Upon this issue, both the High Court and the Court of Appeal correctly held that there was no requirement to register the Memorandum of Deposit because the date of the transaction was prior to the coming into force of the new s 108(3)(k) of the Companies Act which requires a charge on the credit balance of the company in any deposit account to be registered with the Registrar of Companies within 30 days after its creation.

With respect, Counsel for the Lessee was overstating his case, because even if his contention that there had been a breach of s 108(1) of the Companies Act were correct, the effect would have been merely to render

void the security on the company's property or undertaking but the contract or obligation for repayment of the money secured by the charge, would be valid and enforceable, and immediately become payable. (See, s 108(2) and (3) of the Companies Act).

*Result*

In the result, the appeal is allowed with costs here and in the courts below and the judgment of the High Court and the Court of Appeal are hereby reversed. The Lessor is entitled to the set-off claimed. The deposit paid by way of security for costs must be refunded.

*Appeal allowed with costs.*

Reported by Loo Lai Mee